

February 25, 2002

To: Supervisor Zev Yaroslavsky, Chair
Supervisor Gloria Molina
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From: David E. Janssen
Chief Administrative Officer

STATE LEGISLATIVE UPDATE

LEGISLATIVE ANALYST'S OFFICE (LAO) ANALYSIS OF THE GOVERNOR'S BUDGET

Yesterday, the LAO released its analysis of the Governor's 2002-03 Proposed Budget. While the LAO agrees with the Administration that the California economy will begin to emerge from the recession this spring, they continue to believe that the budget relies on overly optimistic revenue assumptions and understated expenditures.

Assuming adoption of all of the Governor's budget proposals, the LAO concludes that the State would still face a shortfall of about \$5 billion. Approximately \$3.9 billion of this shortfall estimate results from the LAO's projection that revenues in the current year will fall \$2.8 billion below the budget forecast and by another \$1.1 billion in the budget year. Approximately \$1.1 billion of the shortfall results from their projection of understated expenditures, primarily related to Proposition 98's minimum guarantee to schools.

In addition, the LAO continues to believe that the Administration's expectation of an additional \$1.1 billion of new Federal funds is overly optimistic and that the \$5 billion shortfall could grow. In the long term, the LAO indicates that because the budget's heavy reliance on borrowing and one-time solutions does not address the underlying structural problems in the State budget, the State faces the risk of another major budget shortfall in 2003-04.

The LAO offers qualified support for some of the major elements of the Governor's proposed solution to the \$12.5 billion budget gap. Securitization of tobacco settlement funds, in effect a \$2.4 billion "loan" to the General Fund, is endorsed in concept pending

analysis of the details. A one-year \$672 million loan from the Traffic Congestion Relief Program to the General Fund is endorsed, with a suggestion that the amount can probably be increased. Also, the Governor's proposal to shift \$115 million in capital expenditures from the General Fund to lease-payment bonds is considered a feasible option.

However, the LAO strongly recommends against deferring State retirement contributions in return for future benefit improvements. Not implementing this option adds almost a billion dollars to the budget problem. (The Administration has recently indicated it would not pursue this proposal.) The LAO recommends that all the borrowing proposals be weighed against their cost and impact on future budgets, and that other options be considered such as refinancing State debt or increasing the amount borrowed against tobacco funds. Finally, the Governor's budget solution contains \$5.2 billion in spending reductions, including \$2.2 billion in current year spending that have already been enacted.

A copy of the summary of the LAO analysis is contained in Attachment I, and the full report can be found at www.lao.ca.gov. The LAO's analysis of major budget year issues that impact the County follows.

LAO ANALYSIS HIGHLIGHTS

Health

Tobacco Settlement Securitization. The LAO suggests that the Governor's proposal to securitize part of the State's future tobacco settlement revenues is generally a reasonable step for the Legislature to consider, but recommends that the Legislature consider the option only after a more detailed proposal is provided.

Federal Medicaid Funding. The LAO notes that the budget assumption of \$400 million in savings resulting from increased Federal support for the Medi-Cal program represents a substantial budget risk because it is dependent on Federal legislative action. Similarly, the LAO indicates that the budget assumption of \$50 million in savings from unspecified proposals to maximize Federal funds is also risky because it lacks details.

DSH Administrative Fee. The LAO recommends adoption of the Administration's proposal to increase the State Administrative Fee in Medi-Cal Disproportionate Share Hospital (DSH) payment program by \$55 million.

Hospital System Stability. The LAO acknowledges the financial pressures facing all hospitals in the next several years, such as the recent Federal Upper Payment Limit regulation which restricts the amount of Federal funds available to public hospitals

participating in Medi-Cal. Recognizing the State's interest in the financial stability of the hospital network, especially public hospitals, the LAO recommends the Legislature consider the following options:

- Direct the Office of Statewide Health Planning and Development to assess hospital bed vacancy rates and determine oversupply or under supply on a regional basis to identify opportunities for hospital consolidation.
- Increase the Medi-Cal and Healthy Families Program co-payments for nonemergency care in emergency departments without a corresponding reduction in provider rates.
- Direct the State Department of Health Services and the California Medical Assistance Commission to conduct a fiscal analysis of the new Federal Upper Payment Limit regulation to fully assess the impact on hospitals.

Medi-Cal Provider Rates. The LAO recommends that the Legislature not adopt the Governor's proposal to cut provider rates by \$78 million (General Fund) because rates are generally so low that further reductions may reduce patient access to care or quality of care. Instead, the LAO recommends expanding the medical case management program to additional Medi-Cal patients for an estimated General Fund savings of \$17 million, and correcting overpayments in the Medi-Cal managed care program for General Fund savings of up to \$7 million. The LAO further suggests that the Legislature establish a process for periodically adjusting Medi-Cal fee-for-service rates.

Medi-Cal Copayments. The LAO recommends that the Legislature not adopt the Governor's proposal to reduce provider reimbursements by the amount of proposed Medi-Cal beneficiary copayments because the provider's payment is effectively reduced if the provider is unable to collect the copayment. The LAO also suggests that copayments may result in a reduction in access to Medi-Cal providers and a corresponding increase in emergency room use for routine care. Alternatively, the LAO recommends that a Medi-Cal copayment system be structured to create a deterrent to overutilization of non-essential services, such as nonemergency use of emergency rooms, while exempting essential preventive services and medications. These copayments would constitute additional payments to providers instead of reducing provider rates by copayment amounts.

Medi-Cal Managed Care. The LAO indicates that when the Medi-Cal Program first expanded its use of managed care in the early 1980s, the fee-for-service population was comparable to the managed care population and managed care rates were based on the rates paid to fee-for-service providers. Now that the fee-for-service population (largely the

elderly and disabled) is no longer comparable to the managed care population (primarily children and families), the LAO recommends options for reforming Medi-Cal managed care, including changing the way that managed care rates are set, increasing competition among health plans, and enrolling the elderly and disabled in managed care.

Healthy Families Parent Expansion. The Governor's Budget proposed to delay funding the Healthy Families expansion to parents until July 2003, largely because the Federal government had not approved California's waiver. Now that the waiver has been approved, the Governor has indicated his willingness to work with the Legislature to identify funding. The LAO points out that it would cost \$96 million to cover 187,000 parents in the budget year; however, the cost could be reduced to \$30 million by delaying expansion to January 2003.

State Loss of SCHIP Funds. The LAO estimates that the State is at risk of losing up to \$984 million in unspent Federal State Children's Health Insurance Program (SCHIP) funds over the next two years. The LAO recommends that the Legislature work with the State's Congressional delegation to address this potential loss. The LAO identifies examples of one-time options such as attempting to draw down Federal matching funds for abatement of lead in schools and low-income residences, or long-term options including premium assistance to low-income or recently unemployed workers. The LAO indicates that the Bush administration is encouraging States to coordinate waiver proposals with the private insurance market through premium assistance programs.

CHDP Program Reform. The Governor proposes to eliminate the Child Health and Disability Prevention (CHDP) program and move eligible children into the Medi-Cal and Healthy Families programs, which are more comprehensive health care systems. The LAO agrees in concept, but suggests that the Governor's proposal lacks sufficient detail regarding implementation. It does not provide funding for outreach and enrollment of children in the Medi-Cal and Healthy Families programs, nor does it adequately address children who would remain ineligible for enrollment in either program.

Mental Health

Services for Special Education Students. The Governor's Budget would eliminate the categorical funding for mental health services for special education pupils and provide only \$47.9 million for mandate reimbursements in 2002-03. The LAO recommends that the Legislature reject this proposal and instead, set aside funding pending development of a new program of county mental health services for special education pupils.

Early and Periodic Screening, Diagnosis, and Treatment Services (EPSDT). The Governor's budget proposes a \$133.7 million increase in reimbursement for EPSDT. The

LAO is concerned about the 29 percent annual growth in the cost of EPSDT services, noting that the financial structure of the program (nearly all increases in non-federal costs are borne by the State) provides little incentive for counties to control costs. The LAO recommends that the State Department of Mental Health report during budget hearings on the reasons for the cost increases and what can be done to control them.

Social Services

CalWORKs Performance Incentives. The LAO indicates that determining the methodology for reappropriating unspent Performance Incentive funds and continuing the State's obligation to repay counties for previously earned incentives are legislative policy decisions. The LAO suggests that the Legislature could use even more than the \$169 million of unspent funds that the Governor recommended "borrowing" in the event they wish to adjust the cash grant for inflation, augment the TANF reserve for future program needs, or reduce General Fund expenditures. However, the LAO notes that some counties are using Performance Incentive funds to pay for employment services because their single allocation grant is insufficient.

CalWORKs County Program Grant/Single Allocation. The LAO recommends adoption of the proposed CalWORKs County Program Grant which would consolidate the CalWORKs Single Allocation with mental health, substance abuse treatment, and probation services funded by TANF. The LAO observes that some counties' employment services and administrative cost allocations are underfunded and that 11 counties (including Los Angeles) had welfare-to-work allocations that were below a minimum standard. The Governor's proposal to freeze budget-year allocations would perpetuate this underfunding. In addition, the LAO indicates that the Governor's Budget does not incorporate a new CalWORKs budgeting methodology, as requested by the Legislature, and instead, uses the welfare-to-work component as the "balancing entry" in order to maintain CalWORKs expenditures within available resources.

CalWORKs Long-Term Budget Plan. The LAO believes that the CalWORKs program requires a long-term budget plan to address fiscal pressures such as the recession, counties exhausting their Performance Incentive funds, the erosion of unspent TANF balances, the cost of providing the statutory COLA and the potential for reduced Federal funding during TANF reauthorization by Congress.

CalWORKs Child Care. The LAO indicates that about 6,000 children would lose eligibility as a result of the Administration's proposed reform of California's subsidized child care system. They recommend no action be taken until the May Revision, pending additional details from the Administration.

Foster Family Agencies (FFAs). The LAO recommends that the Legislature consider three options to limit or reduce the use of FFA placements: 1) hold funding to current-year levels; 2) decrease FFA treatment placements by 20 percent; or 3) reduce FFA rates over time.

California Food Assistance Program (CFAP). The LAO indicates that the proposed \$35 million General Fund savings associated with eliminating CFAP is dependent on full restoration of Federal Food Stamp eligibility for the CFAP caseload.

Public Safety

Youth Authority Commitments. Counties are required to share the cost of housing wards at the Youth Authority. The LAO is recommends removing the existing cap on fees and adjusting them for inflation, which will increase County costs.

Community Law Enforcement and Recovery (CLEAR). The LAO recommends deletion of the \$3 million proposed for the CLEAR program because its effectiveness has not been established, and local law enforcement agencies have other sources of funding such as the State's Citizens' Option for Public Safety and juvenile justice grant programs.

Fee and Assessment Increases. The Governor's Budget contemplates increases in revenue from civil and criminal filing fees due in part to new surcharges. The LAO believes the \$61 million in revenue is overstated because judges often set the fee based on the defendant's ability to pay.

Turning Point Academy. The Administration proposes to change eligibility requirements so that more candidates will qualify for the Academy. The LAO recommends no augmentations until bill language is available.

Antiterrorism Programs. The Governor's Budget assumes \$350 million in new Federal aid, of which \$164 million is used for enhanced State security measures. However, the additional \$176 million is not addressed. The LAO recommends that State antiterrorism responsibilities be better defined and that the Administration's plans for the use of the additional \$176 million in anticipated funding should be specified by the May Revision.

Fire. The Governor's budget recommends shifting the cost of fire protection in State Responsibility Areas to local governments. The County Fire Department estimated their additional costs to be from \$6 to 9 million. The LAO questions the savings from this proposal and advises no action until details are available.

Child Support Administration

Child Support Automation. The LAO indicates that the assumption that California's child support automation penalty will be eliminated by Federal legislation creates a substantial budget risk, approximately \$181 million to the General Fund.

Vehicle License Fee

Vehicle License Fee. While the LAO devotes an entire section of their report to the VLF, they are judicious in their comments. While emphasizing its importance as a source of revenue to local governments, they also note that the cost in the budget year of reimbursing local governments for the 67.5 percent reduction in the fee is \$3.8 billion. In addition, they point out that the reduction is worth about \$124 annually to the average vehicle owner. Much of the discussion focuses on the requirement that the fees automatically increase when there is "insufficient moneys" to finance the local government backfill, noting ambiguity about what constitutes "insufficient moneys", who is supposed to determine it, and, if the decision-maker is the Legislature, whether it would require a two-thirds vote.

LAO Report on Options for Addressing the State's Fiscal Problems

In addition to their analysis of the Governor's Proposed Budget, the LAO issued another report containing over 100 expenditure reduction/revenue raising options that the Legislature could use in crafting a budget solution. The report, similar to others developed during past State budget shortfalls, outlines an array of options ranging from reductions in programs, such as Medi-Cal and CalWORKs, to changes in policies such as criminal justice and taxation. Given the magnitude of the State budget shortfall, the LAO's options are likely to be seriously considered. We are working with affected departments to analyze these options, and will report back on their impact to the County.

OTHER STATE BUDGET DEVELOPMENTS

The Senate Budget and Fiscal Review Committee will begin its hearings on Wednesday, February 27, 2002. A copy of their hearing schedule is contained in Attachment II. The Assembly has not yet published its full schedule of budget subcommittee hearings in the Daily File, although they are expected to start around the same time.

PURSUIT OF COUNTY POSITION ON LEGISLATION

SB 1351 (Chesbro) would mandate disability benefits under Section 4850 of the Labor Code for County welfare fraud investigators, entitling them to public safety workers'

compensation benefits. Section 4850 provides for a leave of absence at full pay for 365 days for injury or illness for such positions as sheriffs, firefighters, probation officers, district attorney investigators, safety police officers, and full-time lifeguards. All other employees not covered by Section 4850, including welfare fraud investigators, are currently entitled to benefits up to 70 percent of their base salary for one year. In Los Angeles County, the duties of the welfare fraud investigators are administrative in nature and they are not required to carry firearms, serve search warrants on residences, or make arrests. **The County will be opposing SB 1351 based upon current policy to oppose legislation that mandates eligibility for additional employees into safety workers' compensation or safety retirement benefit provisions of current law.** SB 1351 was introduced on February 5, 2002 and is currently in the Senate Committee on Labor and Industrial Relations with no hearing date set.

We will continue to keep you advised.

DEJ:GK
IGR:md

Attachments

- c: Executive Officer, Board of Supervisors
- County Counsel
- All Department Heads
- Legislative Strategist
- Local 660
- Coalition of County Unions
- California Contract Cities Association
- Independent Cities Association
- League of California Cities
- City Managers Associations
- Buddy Program Participants